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In The

Supreme Court of the United States

October Term, 1996

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Petitioner,

v.

DAVID MARGEN AND LAWTON ASSOCIATES,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION

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34 pp

LIST OF INTERESTED PARTIES
(SUPREME COURT RULES 14(b) AND 29.6)

Respondent David Margen and Petitioner Tevis T. Thompson, Jr. are individuals. Mr. Thompson is a party to this matter in his capacity as trustee of the chapter 7 estate of James Delbert and Clara Mae McConville, individuals.

Respondent Lawton Associates is a California general partnership. Its partners are Susan V. Smartt, Louis J. Lovotti, Ronald J. Kriss, and Susan Peck. Lawton Associates has not issued shares to the public, and it is not a parent, subsidiary, or affiliate of any company that has issued shares to the public.

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I.

STATEMENT OF THE CASE

This matter involves the fact-intensive application of an equitable remedy to the unique circumstances of this case. The decision of the Ninth Circuit Court of Appeals follows a half-century of existing authority, creates no conflict among the circuits, and achieves an equitable result.[1] No basis exists for reviewing this case on certiorari.

Because of the discretionary nature of the remedy at issue in this case, it is important for this Court to have a clear presentation of all the circumstances that compelled the Ninth Circuit to reach its equitable result. Unfortunately, the Petition presents a one-sided view of the case, obscuring or ignoring essential factual findings (including at least one to which Petitioner stipulated) that form the basis of the decision below.

The Debtors, James and Clara McConville, were in the business of buying distressed real properties with the intent of operating and reselling them for a profit. Petitioner's Appendix ("Pet. App.") at 4a, 3e. On July 8, 1993, Debtors entered into a contract to purchase a bank-owned apartment building in Oakland, California (the "Property") for $122,000. *Id.* at 4a, 2e. Debtors subsequently opened a thirty-day escrow and made a $10,000, nonrefundable deposit into escrow. *Id.* at 4a. Debtors later made an additional $5,000 nonrefundable deposit to

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[1] As discussed further herein, the Ninth Circuit's only error was to deny Respondents a lien to secure more than four years of interest earned on their loan.

extend the escrow for approximately one week when they were unable to close the transaction timely. *Id.* at 4a-5a, 2e.

Debtors' primary source of financing fell through just before the scheduled closing date. *Id.* at 4a-5a. In order to go forward with the purchase and not forfeit their $15,000 deposit, Debtors requested thirty-day bridge financing from Respondents, David Margen and Lawton Associates. *Id.* at 5a. The parties expected that after thirty days Debtors would be able to obtain permanent financing and repay Respondents. According to the Bankruptcy Court, "[w]hile the terms of the loan were not favorable to the [D]ebtors, the evidence indicates that [D]ebtors knew what they were doing, and, in the totality of the circumstances, the loan was an arm's length transaction between the [Respondents] and the [D]ebtors." *Id.* at 4e.

Respondents had prior business experience with Debtors and did not require Debtors to present a current financial statement. However, Respondents did inquire into Debtors' credit history and received a favorable report. *Id.* at 5a, 3e-4e. The Bankruptcy Court found that Respondents "reasonably relied" upon the information they received regarding Debtors' creditworthiness. *Id.* at 3e-4e. Further, there was no evidence in the Property's chain of title to show that Debtors lacked the authority to grant a first priority purchase money lien on the Property to secure repayment.

On August 13, 1997, Respondents advanced Debtors $97,000 evidenced by a promissory note (the "Note").[2] The Note was secured by a purchase money, first deed of trust on the Property, which was recorded contemporaneously with the recording of Debtors' deed. *Id.* at 3e. Debtors used the moneys Respondents advanced to purchase the Property.

Unbeknownst to Respondents when they made the loan, Debtors were in bankruptcy. Debtors had filed a petition under chapter 11 of the Bankruptcy Code[3] on July 14, 1993, approximately one month before the transaction closed. Debtors failed to record their bankruptcy petition with the county recorder in accordance with Bankruptcy Code section 549(c). Nor did Debtors notify any of the parties to the transaction, including Respondents, of their status as chapter 11 debtors in possession. *Id.* at 5a, 4e. In fact, Petitioner *stipulated* that "[t]he [Respondents], Lawton Associates and David Margen had no knowledge of the filing of a petition in bankruptcy by James and Clara McConville at the time the defendants made a loan to the debtors for the purchase of the Property."

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[2] The Note provided for 12% interest per annum and also included a $10,000 fee. The fee was not paid by Debtors, but rather was accounted for by increasing the face amount of the Note to $107,000. Respondents withdrew their request for the fee prior to trial and agreed to enforce the Note as if its principal amount were $97,000. The fee is *not* a component of the equitable lien granted by the Ninth Circuit, which is limited to the $97,000 actually advanced by Respondents.

[3] All references herein to the "Bankruptcy Code" are to title 11 of the United States Code, 11 U.S.C. § ___.

Debtors failed to make a single payment to Respondents on account of the Note. As of the present, the entire $97,000 Respondents advanced remains unpaid, in addition to more than four years of accrued, unpaid interest.

On September 13, 1993, Debtors' chapter 11 case was converted to one under chapter 7 of the Bankruptcy Code, and Petitioner was appointed as trustee of Debtors' chapter 7 bankruptcy estate. Respondents unsuccessfully sought permission to foreclose on the Property on account of Debtors' failure to repay the loan. Petitioner ultimately resold the Property for $137,000, resulting in a $15,000 profit. Despite their lien on the Property, Respondents have never been repaid their loan from the sale proceeds.

Petitioner brought this action to avoid Respondents' deed of trust, thereby seeking to retain all of the proceeds of the Property's sale for the Debtors' estate. Petitioner alleged that Respondents' deed of trust was avoidable under Bankruptcy Code section 549(a), which provides for the avoidance of unauthorized postpetition "transfers" of estate property. According to Petitioner, because Debtors failed to obtain court approval for Respondents' secured loan, the loan and deed of trust violated both the automatic stay of Bankruptcy Code section 362 and the restrictions on postbankruptcy financings of section 364. Due to Debtors' insolvency, the probable effect of Petitioner's action, if successful, would be to deprive Respondents of any recovery whatsoever on their loan.

In defense, Respondents introduced evidence that they had acted in good faith and without knowledge of Debtors' bankruptcy case. Respondents sought protection under Bankruptcy Code section 549(c), which exempts

from the trustee's section 549(a) avoiding powers real property transfers to "good faith" transferees without knowledge of the pending bankruptcy.[4] Respondents further requested that, if their deed of trust were avoided, they be granted a "Federal improvement lien" on the Property to the extent they advanced funds to Debtors that benefited the bankruptcy estate.

The Bankruptcy Court ruled in favor of Petitioner and avoided Respondents' lien. The Court found that Respondents had acted in good faith in making the loan, Pet. App. at 5e, that they had no knowledge of the bankruptcy at the time the loan was made, *id.*, and that the loan was a bona fide, arm's length transaction, *id.* at 4e. The Bankruptcy Court nonetheless concluded that the creation and recordation of the deed of trust without prior court approval violated Bankruptcy Code sections 362 and 364, and was avoidable under section 549(a). *Id.* The Bankruptcy Court further held that Respondents were not entitled to the protections of Bankruptcy Code section 549(c) for good faith transferees because, according to the Bankruptcy Court, the transfer to Respondents was not a "transfer of real property." The District Court affirmed on the grounds that the lien was avoidable under Bankruptcy Code section 549(a), without addressing sections 362 or 364.

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[4] Specifically, Bankruptcy Code section 549(c) exempts from the section 549(a) avoiding powers "a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value. . . ." The term "purchaser" under Bankruptcy Code section 101(43) includes any recipient of a voluntary transfer.

The Ninth Circuit initially affirmed the lower courts' decisions, but on different grounds. Applying Ninth Circuit precedents, *In re Schwartz*, 954 F.2d 569, 574 (9th Cir. 1992), and *In re Shamblin*, 890 F.2d 123, 127 (9th Cir. 1989), the Court held that the postbankruptcy creation and recordation of Respondents' lien was not a "transfer" for purposes of Bankruptcy Code section 549. Thus, the Ninth Circuit rejected both Petitioner's argument that Respondents' deed of trust could be avoided under Bankruptcy Code section 549(a), and Respondents' argument that their lien was unavoidable because the good faith defense of section 549(c) applied. Instead, the Ninth Circuit initially held that Respondents' lien was void solely because it violated the automatic stay of Bankruptcy Code section 362.

Upon petition for rehearing, the Ninth Circuit requested further briefing and invited the parties to raise any legal issues relevant to resolution of the appeal. In addition to renewing his section 362 and 549(a) arguments, Petitioner reasserted that Respondents' loan violated Bankruptcy Code section 364. Respondents in turn directed the Court to cases which have allowed good faith lenders to retain their liens notwithstanding any violation of section 364 when a benefit is conferred upon a debtor's estate.

The Ninth Circuit ultimately vacated its prior decision and reversed, concluding that Bankruptcy Code section 364 is the proper statutory basis for resolving this dispute. Unlike Bankruptcy Code sections 362 and 549, which are of more general application, Bankruptcy Code section 364 expressly applies to "obtaining credit" and the voluntary granting of postbankruptcy liens, such as

Respondents' loan to Debtors. The Ninth Circuit held that, by obtaining secured credit without a court order, Debtors violated Bankruptcy Code section 364(c), which generally requires that such credit be obtained only after notice and a hearing. The Ninth Circuit accordingly annulled the unauthorized loan transaction.

Since Debtors already had received and spent the loan proceeds to purchase the Property, Debtors could not simply return the proceeds. Recognizing its authority to take into account "the equities of the situation . . . within the limits set by the [Bankruptcy] Code," Pet. App. at 8a, the Ninth Circuit granted to Respondents an equitable lien for $97,000, the amount they had advanced to Debtors.

In determining whether an equitable lien was appropriate, the Ninth Circuit weighed the equities of the case, including the facts that Respondents' loan enabled Debtors to obtain the Property (which was resold for a profit), the loan benefited the estate, and Respondents had acted without knowledge of the bankruptcy case. The Ninth Circuit concluded that "[i]n these circumstances, we think it equitable that the [Respondents] get back the amount they lent. . . . " *Id.* The Ninth Circuit ordered a remand to the lower courts to provide that Respondents "have a lien on $97,000 of the estate." *Id.* at 9a. The Ninth Circuit did not, however, grant Respondents a lien to account for the more than four years of unpaid interest which had accrued on the loan. Thus, while Respondents are to be repaid the moneys they advanced, the bankruptcy estate effectively still will have received a four-year, interest-free loan.

II.

SUMMARY OF THE REASONS WHY THE PETITION SHOULD BE DENIED

This case clearly does not satisfy the criteria this Court routinely applies when considering whether to grant certiorari. The Ninth Circuit's decision does not establish any new precedent, but rather faithfully applies well established equitable doctrines to the unique facts of this case.

The Ninth Circuit's application of Bankruptcy Code section 364 is entirely consistent with the holdings of other courts which have recognized equitable remedies for unauthorized postpetition borrowings. The undisputed record in this case shows that Respondents acted in good faith, without knowledge of the bankruptcy, and for the benefit of Debtors' estate. The granting of an equitable lien to Respondents is correct as a matter of law, equity, and common sense.

Although Petitioner asserts circuit conflicts and a "flood of litigation" resulting from the decision below, none of Petitioner's arguments ring true. The Ninth Circuit's focus on the peculiar facts of this case significantly limits the decision's precedential value.

The "conflicting" cases Petitioner cites are distinguishable, or suggest some indirect tension at most. By asserting these "conflicts", Petitioner is effectively asking this Court to grant certiorari to interpret a statute that is the subject of a single string citation in the decision below. Moreover, if, as Petitioner contends, this statute governed the outcome of this case, then Respondents would be entitled to various defenses that would provide

an independent basis for the Ninth Circuit to reach the same result.

Finally, Petitioner's claim of procedural error is unavailing. The granting of a lien in Respondents' favor was well within the Ninth Circuit's authority and consistent with the form of the relief sought by the parties in this case. In any event, even if the procedural issues Petitioner raises were valid, they do not implicate conflicts among the circuits or other issues of national significance, and thus do not justify granting the Petition. The Petition should be denied.[5]

III.

REASONS FOR DENYING THE PETITION

A. The Grant Of An Equitable Lien In An Amount Equal To The Funds Respondents Advanced To Debtors Is An Appropriate Discretionary Remedy Under Bankruptcy Code Section 364 And Is Consistent With Well Established Case Law.

1. The Courts Have Broad Discretion To Fashion Equitable Relief To Protect Third Parties Who Lend Money To A Debtor In Good Faith And Without Knowledge Of The Bankruptcy Case.

Bankruptcy Code section 364 provides that a bankruptcy trustee or debtor in possession may obtain priority or secured credit outside of the ordinary course of business "after notice and a hearing." As Petitioner correctly

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[5] In the event the Petition is granted, this Court should also grant Respondents' Conditional Cross-Petition, which is being filed concurrently with this opposition.

notes, the consequence of failing to obtain prior court approval of such credit generally will include a denial of any priority or lien status for the lender. *See William B. Schnach Retirement Trust v. Unified Capital Corp. (In re Bono Dev., Inc.)*, 8 F.3d 720, 722 (10th Cir. 1993). Petitioner fails to acknowledge, however, that this general rule is subject to equitable exceptions that the Ninth Circuit correctly applied in this case.

For more than half a century, courts have recognized their authority to approve the terms of loans to debtors *nunc pro tunc* if the equities of the case so dictate. *See Wolf v. Nazareth Fair Grounds & Farmers' Market, Inc.*, 280 F.2d 891 (2d Cir. 1960) (per curiam); *In re American Cooler Co.*, 125 F.2d 496 (2d Cir. 1942); *see also* 3 *Collier on Bankruptcy* ¶ 364.03[2] at 364-9 (15th ed. rev. 1996). While such relief generally should be granted only in "unusual circumstances," courts may do so when the lender acted in good faith and the debtor's other creditors benefited from the loan. *See Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Associates, Inc.)*, 881 F.2d 6 (2d Cir. 1989); *American Cooler*, 125 F.2d at 497.

Moreover, even when an after-the-fact authorization of an entire loan transaction is not appropriate, courts have the power to grant good faith lenders equitable relief, including lien creditor status, as did the Ninth Circuit in the present case. *See, e.g., In re Smith*, 119 B.R. 558 (S.D. Ohio 1989) (affirming grant of equitable lien to secure unauthorized postpetition financing); *Bensten v. Grant (In re Gloria Mfg. Corp.)*, 65 B.R. 341, 346-48 (E.D. Va. 1985) (affirming bankruptcy court's grant of super priority over all other creditors on account of unauthorized loan that benefited estate); *National City*

Bank v. Imbody (In re Imbody), 104 B.R. 830, 834-36 (Bankr. N.D. Ohio 1989) (granting *nunc pro tunc* approval of postpetition secured financing); *see also In re City Wide Press, Inc.*, 110 B.R. 710, 711 (E.D. Pa. 1990) (recognizing that court has "discretionary power to authorize a senior claim under § 364(d) *nunc pro tunc*," but declining to do so due to lack of any writing evidencing secured loan); *In re Lite Coal Mining Co.*, 122 B.R. 692, 695-96 (Bankr. N.D. W. Va. 1990) (recognizing court's authority to grant super priority status under section 364(c), but declining to do so on facts of case).

The equities of the present case weigh even more heavily in favor of an equitable lien than those in *In re Smith, supra*, in which the district court affirmed the grant of such a lien for the benefit of a postpetition lender who had failed to obtain prior bankruptcy court approval for its loan. The lender ("Ohio Grain") had extended $100,000 in credit to a chapter 11 debtor in possession secured by a lien on the debtor's crops. Ohio Grain was aware of the debtor's bankruptcy, but mistakenly believed that prior approval of the loan was unnecessary. Another creditor asserting a competing lien on the crops challenged Ohio Grain's lien, claiming that the lien was void under Bankruptcy Code section 364.

Notwithstanding Ohio Grain's failure to follow proper procedure, the bankruptcy court granted Ohio Grain an equitable lien on the crops, and the district court affirmed. According to the district court:

> This is not a case where the debtor has attempted to grant a lien to a creditor in previously unencumbered property at the expense of general creditors. The fundamental fact is that

> Ohio Grain's loan did not just preserve the bankruptcy estate, but in fact created a portion of that estate. In the absence of Ohio Grain Company's loan, the estate would not have possessed the 1986 crop. Despite the failure of Debtors and Ohio Grain Company to follow the proper procedures in gaining court approval for the loan, this Court agrees with the Bankruptcy Court that it would be unjust to permit Debtors' other creditors to profit from Ohio Grain Company's mistake.

119 B.R. at 565 (quotations omitted).

In the present case, Respondents' loan likewise did not encumber existing estate property at the expense of other creditors. Respondents' loan created an asset by enabling the Debtors to purchase the Property, which was later resold for a profit. Without this loan, Debtors would not have acquired the Property, and instead would have forfeited their $15,000 nonrefundable deposit. Moreover, the record in this case is clear that Respondents acted in good faith and had no knowledge of Debtors' chapter 11 case, due in large part to Debtors' own failure to notify the parties of their bankrupt status. Finally, it is unlikely that Respondents will ever be repaid so much as a penny of their $97,000 absent a lien on the sale proceeds. Consistent with the holdings of *American Cooler*, *In re Smith*, and other cases which have recognized the courts' discretion to award equitable relief to good faith lenders, the Ninth Circuit reasonably concluded that "[i]n these circumstances, we think it equitable that the [Respondents] get

back the amount they lent," and granted them a lien in that amount. Pet. App. at 8a.[6]

2. The Ninth Circuit's Holding Is Consistent With The Second Circuit's Holding In *Photo Promotion Associates.*

Petitioner mischaracterizes the Second Circuit's decision in *Photo Promotion Associates* in an effort to create the appearance of a conflict where none actually exists. In fact, *Photo Promotion* recognizes the same equitable principles applied by the Ninth Circuit in this case, and its reasoning supports the decision below.

In *Photo Promotion,* a creditor ("Colorchrome") entered into a post-bankruptcy financing agreement with the debtor that was secured by an assignment of the debtor's accounts receivable. Colorchrome failed to obtain court approval for the secured financing even though, unlike Respondents, Colorchrome knew that the debtor was in chapter 11. *See Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Associates, Inc.),* 87 B.R. 835, 837 (Bankr. S.D.N.Y. 1988). The bankruptcy court on motion for summary judgment invalidated Colorchrome's security interest for failure to obtain court approval under Bankruptcy Code section 364(c). On remand from an initial appeal to the district court, the bankruptcy court granted Colorchrome administrative priority status

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[6] Respondents believe that the Ninth Circuit's only mistake was failing to protect their rights fully by extending the equitable lien to include not just the principal amount loaned, but also any interest earned at the contract rate of 12% per annum.

for its claims, but required Colorchrome to refund any payments it had already received.

In affirming the lower courts' decisions, the Second Circuit made it clear that the courts have "broad discretion" in applying Bankruptcy Code sections 364 and 549 and fashioning remedies thereunder. 881 F.2d at 8. "[A] court may authorize administrative expenses retroactively when the equities of the situation require it. . . . " *Id.* at 9 (following *Wolf v. Nazareth Fair Grounds*, 280 F.2d at 892; *American Cooler*, 125 F.2d at 497). "Whether to grant or deny retroactive authorization requires an ad hoc assessment of the facts and equities of each case." *Id.*

As did the Ninth Circuit in the present case, the Second Circuit emphasized that the primary considerations are " 'the good faith of the debtor and lender [and] whether or not they honestly believed that they had authority to enter into the transaction.' " *Id.* (quoting *American Cooler*, 125 F.2d at 497). These are precisely the considerations that the Ninth Circuit took into account in awarding equitable relief to Respondents.

Contrary to Petitioner's assertion, the Second Circuit did not hold (or even suggest) that it lacked authority to grant the lender an equitable lien or other form of security. The Second Circuit did not authorize a lien in *Photo Promotion* only because the equities in that case were significantly different from those present here. Among other things, Colorchrome admitted that it knew that the debtor was under the protection of the bankruptcy laws when it made the loans. Under these circumstances, the Second Circuit held that "[t]he equities of this case . . . weigh heavily against retroactive authorization" of a

secured financing. 881 F.2d at 9. In any event, the question of Colorchrome's security was not even before that court, because Colorchrome abandoned on appeal its right to "contest [the bankruptcy] court's ruling that the debtor's assignment of its accounts receivable to Colorchrome did not create a security interest because of the absence of court approval." 87 B.R. at 837.

The Second Circuit's holding, which recognizes a court's discretion to weigh the equities of the particular case, is entirely consistent with what the Ninth Circuit did below. Although the Second Circuit declined to apply the same remedy as did the Ninth Circuit, that is not because of any conflict in the law. Rather, it is because the courts faced significantly different factual circumstances. There is no conflict as to the basic legal principle that courts have the discretion to formulate equitable remedies under section 364. Certiorari on this issue is not warranted.

B. Nearly All Of Petitioner's Other Asserted Grounds For Granting Certiorari Involve Interpretations Of Statutes That Did Not Form The Basis Of The Ninth Circuit's Decision, And That Would Not Have Entitled Petitioner To The Relief He Seeks.

The majority of the Petition is devoted not to Bankruptcy Code section 364, which formed the basis for the Ninth Circuit's decision. Rather, the Petition's main focus is (i) the avoiding powers in Bankruptcy Code section 549(a), which the Ninth Circuit found to be inapplicable in this case and disposed of in a single string citation, *see* Pet. App. at 7a (citing *In re Schwartz*, 954 F.2d at 574; *In re*

Shamblin, 890 F.2d at 127), and (ii) the definition of the term "transfer" in Bankruptcy Code section 101(54), which the Ninth Circuit did not even cite. Petitioner wants this Court to grant certiorari to shift the focus of this case to Bankruptcy Code sections 101(54) and 549(a), and to address a multitude of collateral issues that are not the subject of the Ninth Circuit's decision.

As the following discussion demonstrates, none of the "conflicts" and concerns Petitioner cites warrant this Court's intervention. At most, Petitioner identifies some tension among various cases decided in different contexts; none of the cases Petitioner cites squarely conflicts with the Ninth Circuit's decision in this case to rely exclusively upon section 364. Moreover, even if Petitioner were correct that sections 101(54) and 549(a) should have been applied in this case, Respondents would be entitled to assert various defenses under those sections (none of which were resolved by the Ninth Circuit) that would provide independent grounds for affirming the Ninth Circuit's decision. Given the lack of any clear conflict and the existence of defenses that the Ninth Circuit had no occasion to address, this case is not a worthy candidate for review on certiorari.

1. To The Extent Any Tension May Exist In The Interpretation Of Bankruptcy Code Sections 101(54) And 549(a), This Tension Does Not Give Rise To Any Issue Justifying This Court's Review.

In both *Schwartz* and *Shamblin*, the Ninth Circuit held that the postpetition creation of a lien does not constitute

an avoidable "transfer" for purposes of Bankruptcy Code section 549(a). *See Schwartz*, 954 F.2d at 574; *Shamblin*, 890 F.2d at 127. Petitioner contends that, by acknowledging these precedents in this case, the Ninth Circuit has perpetuated conflicts both with a decision of the Fifth Circuit that considered section 549(a) specifically, and with decisions of various courts that have interpreted the term "transfer" in the context of other provisions of the Bankruptcy Code.

The principal case upon which Petitioner relies is *City of Farmers Branch v. Pointer (In re Pointer)*, 952 F.2d 82 (5th Cir.), *cert. denied sub nom., Pointer v. Carrollton-Farmers Branch Indep. Sch. Dist.*, 505 U.S. 1222, 112 S. Ct. 3035 (1992), in which a secured creditor sought to avoid an involuntary tax lien that arose after the commencement of the debtor's bankruptcy. The creditor argued that the creation of the tax lien was an unauthorized "transfer" of property of the debtor's estate. The Fifth Circuit held that the creditor lacked standing to avoid the lien under section 549 and directed that the action be dismissed. *Id.* at 87-89. Before reaching the standing issue, however, the court briefly discussed the applicability of section 549 to the avoidance of involuntary, postpetition liens. In what was arguably dicta, given the creditor's lack of standing, and without citing the Ninth Circuit's prior holdings on the issue, the court indicated that the attachment of the involuntary lien did constitute a "transfer" for purposes of section 549. *Id.* at 87.

Pointer is distinguishable because it involved an involuntary tax lien, rather than a voluntary financing. By its terms, Bankruptcy Code section 364 applies only to voluntary agreements to extend postpetition credit. Thus,

the equitable doctrines that protect good faith lenders were not applicable in *Pointer*, and the Fifth Circuit had no occasion to address them. In contrast, the Ninth Circuit based its decision in the present case exclusively on Bankruptcy Code section 364, rather than section 549, because Respondents' loan to Debtors was a voluntary transaction. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384-85, 112 S. Ct. 2031, 2037 (1992) (more narrowly tailored statute has precedence over statute of general application). Because section 364 forms the underpinnings of the Ninth Circuit's decision in this case, the Ninth Circuit correctly applied the equitable doctrines relating to that statute's application that simply were unavailable in *Pointer*.

The other "conflicts" Petitioner cites involve cases which have nothing to do with the prohibition on unauthorized, postpetition loans. They deal instead with matters such as the avoidance of prebankruptcy preferential and fraudulent transfers under Bankruptcy Code sections 547 and 548. According to Petitioner, the Ninth Circuit's decision will have the effect of exempting the creation of liens from numerous provisions of the Bankruptcy Code that historically have been applied to them. Nowhere in its decision, however, did the Ninth Circuit suggest, or even imply, that its holding would affect the law of preferences, fraudulent conveyances, or any other aspect of bankruptcy law, other than unauthorized postpetition financings under Bankruptcy Code section 364. In fact, the Ninth Circuit has expressly precluded reliance upon its holdings in *Schwartz* and *Shamblin* in any context other than the creation and avoidance of postpetition liens. *See Shamblin*, 890 F.2d at 127 n.7 (recognizing that,

in the context of prebankruptcy transactions, "[t]his court has consistently treated the creation of liens on the debtor's property as a transfer"); *see also Hughes v. Lawson (In re Lawson)*, 1997 WL 469694 (9th Cir. Aug. 8, 1997) (case decided *after* the decision below was reported, holding that creation of a lien was a "transfer" for purposes of determining a debtor's eligibility for discharge under section 727(a)(2)); *In re Wind Power Systems, Inc.*, 841 F.2d 288, 291-92 (9th Cir. 1988) (applying Bankruptcy Code section 547 in action to avoid alleged preferential transfer of lien).

Even if there were some tension among the circuits in connection with their interpretations of the term "transfer" in differing contexts, this tension appears not to have created any significant litigation in the courts to date. During the eight years since the Ninth Circuit decided *Shamblin*, not a single published decision has criticized its holding on this issue. Nor has any court appeared to have commented upon, or even identified, the existence of any conflict on this issue. Thus, Petitioner's assertion that the Ninth Circuit's decision "potentially opens the floodgate to litigation" rings hollow.

The Ninth Circuit's decision applies eight-year old precedent in the area of section 549(a), and fifty-year old precedent in the area of section 364. If this precedent were as potentially unsettling as Petitioner asserts, it certainly has not manifested itself as such to date. While it is possible that this Court may someday have to consider the interrelationship between Bankruptcy Code sections 101(54), 364, and 549, this Court should not grant certiorari to correct problems that do not currently exist.

This Court does not address conflicts that exist only in petitioners' imaginations.

2. Even If This Court Were To Conclude That The Creation Of Respondents' Lien Was A Transfer For Purposes Of Bankruptcy Code Section 549, The Ninth Circuit's Decision Should Be Affirmed On Independent Grounds.

Were this Court to agree with Petitioner that this case should be resolved under Bankruptcy Code section 549, as opposed to section 364 as the Ninth Circuit held, then this Court will also have to address at least two defenses to the avoidance of Respondents' deed of trust under section 549(a). Each of these defenses would provide an independent, alternative ground for affirming the Ninth Circuit's decision.

a. Respondents Would Be Entitled To The Protections Of Section 549(c) As Good Faith Transferees Of Real Property.

While Bankruptcy Code section 549(a) authorizes the avoidance of certain postpetition transfers of property of a debtor's estate, its application is circumscribed by affirmative defenses set forth in Bankruptcy Code sections 549(b) and (c). Of relevance here is section 549(c), which protects good faith transferees of real property by providing that:

> the trustee may not avoid under [section 549(a)] a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent

> value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser.

The record in this case is clear that Respondents acted in "good faith", that they had no knowledge of Debtors' bankruptcy case, and that Debtors failed to record their bankruptcy petition. The only question is whether Respondents were "purchaser[s]" of real property as that term is used in section 549(c). Under Bankruptcy Code section 101(43), any recipient of a voluntary "transfer" qualifies as a "purchaser". *ATC Systems, Inc. v. Valairco, Inc. (In re Valairco, Inc.)*, 9 B.R. 289, 295 (Bankr. D.N.J. 1981) ("A perfected secured creditor's lien is, thus, a purchase within the contemplation of the drafters of the Bankruptcy Code. . . . "). Thus, if the creation and recordation of Respondents' lien qualified as a "transfer" for purposes of section 549(a), as Petitioner contends, then Respondents who were the voluntary recipients of that transfer would qualify as "good faith purchaser[s]" for purposes of section 549(c). *See Brown v. Harris (In re Auxano)*, 96 B.R. 957, 960 (Bankr. W.D. Mo. 1989) (applying section 549(c) to protect holder of deed of trust). Because Respondents were good faith purchasers without knowledge of the bankruptcy, their lien could not be avoided.

b. Respondents' Deed Of Trust Is Unavoidable Under Section 549(a) Because It Did Not Involve A Transfer Of Property Of Debtors' Bankruptcy Estate.

By its own terms, section 549(a) applies only to a "transfer of property of the estate" created by the debtor's bankruptcy. Accordingly, if the interest transferred is in property that does not belong to the debtor's estate, the transfer cannot be avoided under section 549(a). *See Moratzka v. Visa U.S.A. (In re Calstar, Inc.)*, 159 B.R. 247, 252 (Bankr. D. Minn. 1993); *Geekie v. Watson (In re Watson)*, 65 B.R. 9, 11-12 (Bankr. C.D. Ill. 1986).

In *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825 (1991), this Court held that a lien that arose contemporaneously with the debtor's acquisition of property could not be avoided under a statute that provides for the avoiding of liens that affix to a debtor's exempt property. The debtor in *Farrey* had received title to a home as part of a divorce property settlement. Simultaneous with granting title to the debtor, the divorce court granted a lien on the home to the debtor's former spouse securing payments intended to equalize the property settlement. Thus, as with Debtors in this case, the debtor in *Farrey* obtained title subject to a lien created contemporaneously with the transfer of title.

The debtor in *Farrey* subsequently sought to avoid the lien as impairing his homestead exemption under Bankruptcy Code section 522(f)(1).[7] This Court held that

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[7] Section 522(f)(1) provides that "the debtor may avoid the fixing of a lien on an interest of the debtor in property to the

the debtor could not avoid the lien because the avoiding powers in section 522(f)(1) are limited to those situations in which a lien actually "fixed" on the debtor's property. This Court reasoned that "[t]he statute does not say that the debtor may undo a lien on an interest in property." 500 U.S. at 296, 111 S. Ct. at 1829. Rather, by using the term "fixing", Congress intended to impose a temporal requirement, specifically, that a lien attach to a pre-existing interest of the debtor. 500 U.S. at 298, 111 S. Ct. at 1830 ("[U]nless the debtor had the property interest to which the lien attached at some point *before* the lien attached to that interest, he or she cannot avoid the fixing of the lien.") (emphasis in original).

Bankruptcy Code section 549 imposes a similar temporal requirement by making avoidable only transfers of estate property. As with the avoidance rights set forth in section 522(f)(1), the avoidance powers in section 549 presuppose an interest of the estate which can be transferred. *See Farrey*, 500 U.S. at 296, 111 S. Ct. at 1829.

In this case, the Debtors did not own the Property until escrow closed on August 13, 1993, and the grant deed and deed of trust were recorded and delivered in accordance with the escrow instructions. Under California law, Respondents' purchase money lien is deemed to have arisen simultaneously with the transfer of title to Debtors. *See Van Loben Sels v. Bunnell*, 120 Cal. 680, 683 (1898) ("[T]he execution of the deed and the mortgage [are deemed to be] simultaneous acts.") *Guy v. Carriere*, 5

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extent that such lien impairs an exemption to which the debtor would have been entitled" if the lien had not attached.

Cal. 511, 512 (1855) (the conveyance of a deed and creation of a purchase money mortgage "is in the law considered as one act"); *Walley v. P.M.C. Inv. Co.*, 262 Cal. App. 2d 218, 220 (1968) ("The deed and mortgage back are considered as contemporaneous acts and no lien or charge against the purchaser can be prior to the rights of the vendor under his mortgage."). As in *Farrey*, Debtors did not have an interest in the Property until *after* the transaction closed, at which time the Property already was encumbered by Respondents' lien. Because the attachment and recordation of Respondents' lien on the Property did not affect pre-existing property of the estate, they cannot be avoidable under section 549(a).

C. Petitioner's Assertions Of Procedural Error Are Incorrect, And In Any Event Fail To Raise Any Issues Worthy Of This Court's Review.

Petitioner's final argument for certiorari is that the Ninth Circuit somehow exceeded its authority by rescinding the loan transaction and granting Respondents an equitable lien. According to Petitioner, the Ninth Circuit should have remanded to the Bankruptcy Court rather than weighing the equities of the case itself. Petitioner further argues that the issues of rescission and an equitable lien were not properly raised in the courts below.

No procedural error occurred in this case. The Ninth Circuit was not constrained as Petitioner suggests to merely affirm or reverse the Bankruptcy Court's decision in its entirety. Rather, the Ninth Circuit acted within its authority to impose an appropriate, equitable remedy based upon well established law and the circumstances of

this case as determined by the trier of fact below. *See Borman v. Leiker (In re Borman)*, 886 F.2d 273 (10th Cir. 1989) (imposing remedy of equitable lien on appeal where bankruptcy court had avoided judicial lien); *see also Western Oil & Gas v. United States*, 633 F.2d 803 (9th Cir. 1980) (holding in administrative law context that "a reviewing court has discretion to shape an equitable remedy").

The relief granted by the Ninth Circuit is consistent with the relief Respondents sought below, specifically, a lien to compensate them for the value they contributed to Debtors' estate. In fact, Respondents requested in the Bankruptcy Court that, in the event their deed of trust was avoided, they be given a "Federal improvement lien" to the extent they advanced funds to Debtors. Although Respondents requested such a lien under Bankruptcy Code section 550, rather than the courts' equitable powers under section 364, the effect of the lien is identical, and the evidence Respondents presented for such a lien fully supports the Ninth Circuit's decision: Respondents' loan was made in good faith, without knowledge of Debtors' bankruptcy, and for the benefit of Debtors' other creditors.

The issue of rescission should have been no surprise to Petitioner. It was Petitioner in the first instance who sought to rescind the secured loan by bringing his action to avoid Respondents' deed of trust. The avoidance of a transfer under the Bankruptcy Code is tantamount to the annulling or rescission of that transfer. *See, e.g., NLRB v. Martin Arsham Sewing Co.*, 873 F.2d 884, 887 (6th Cir.), *modified*, 882 F.2d 216 (6th Cir. 1989) (holding that avoiding powers allow trustee to "nullify transfers");

McRoberts v. Transouth Financial (In re Bell), 194 B.R. 192, 197 (Bankr. S.D. Ill. 1996) ("the trustee's avoidance of the creditors' liens results in nullification of the transfer of property represented by those liens", which "means that the transfer is retroactively ineffective"); *Congress Credit Corp. v. AJC Int'l*, 186 B.R. 555, 558 (D.P.R. 1995) ("An avoidance nullifies the transfer."). Moreover, the rescission issue is really a "red herring" in this case. The operative relief granted was not rescission, but the equitable lien equal to Respondents' advances to Debtors' estate.

In any event, Petitioner's procedural arguments do not implicate any circuit conflicts or issues of national significance. Instead, Petitioner is asking this Court to grant certiorari to engage in what is at most mere error correction. Even if Petitioner's claims of procedural error were true, Petitioner has failed to demonstrate why this Court should grant discretionary review in these circumstances. *See Ross v. Moffitt*, 417 U.S. 600, 616-617, 94 S. Ct. 2437, 2447 (1974).

IV.

CONCLUSION

This is a fact-intensive case that does not implicate any conflicts of authority or other issues worthy of this Court's review. The Ninth Circuit's decision is correct as

a matter of law and equity. The Petition for Certiorari should be denied.

Respectfully submitted,

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